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24663

Office-Supreme Court, U.S.
FILED
MAY 23 [illegible]
[illegible] T. FAY, Clerk

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

No.

JAMES R. WATKINS and LUCILE L. WATKINS,
Appellants

v.

UNITED STATES OF AMERICA,
Appellee

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF AND APPENDIX FOR THE APPELLEE

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25
1957

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BRIEF FOR THE APPELLEE

Opinion Below

The findings of fact, conclusions of law and opinion of the District Court (R. 16-29)[1] are reported at 149 F. Supp. 718.

Jurisdiction

This appeal involves individual income tax liability for the years 1949 through 1952. (R. 20.) The judgment of the District Court was entered on March 12, 1957. (R. 29.) Taxpayers' notice of appeal was filed on April 10, 1957.

[1] Record references herein are to the appendix to taxpayers' brief.

(R. 4.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented

The ultimate question is whether royalties received by the taxpayer[2] as transferor of certain patent rights constituted ordinary income or capital gain. For the years 1949 and 1950, the answer depends upon whether there was a "sale" of the patents in question under Section 117(a)(4) of the Internal Revenue Code of 1939, in the light of relevant judicial decisions; for the years 1951 and 1952, the answer depends upon whether taxpayer transferred "all substantial rights" to the patents within the meaning of Section 117(q) of the 1939 Code.

Statute Involved

Internal Revenue Code of 1939:

Sec. 117. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business) * * *

* * * *

(4) [As amended by Sec. 150(a)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital

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[2] Taxpayer James R. Watkins is referred to throughout this brief as "the taxpayer," since taxpayer Lucile L. Watkins is party to this litigation solely by virtue of the fact that she is the wife of James R. Watkins and filed joint returns with him for the tax years in question.

asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * *

(q) [As added by Sec. 1 of the Act of June 29, 1956, c. 464, 70 Stat. 404] *Transfer of Patent Rights.*—

(1) *General rule.*—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(A) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(B) contingent on the productivity, use, or disposition of the property transferred.

(2) *"Holder" defined.*—For purposes of this subsection, the term "holder" means—

(A) any individual whose efforts created such property, or

(B) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(i) the employer of such creator, nor

(ii) related to such creator (within the meaning of paragraph (3)).

(3) *Exceptions.*—This subsection shall not apply to any transfer described in paragraph (1)—

(A) by a nonresident alien individual, or

(B) between an individual and any related person.

For purposes of this paragraph, the term "related person" means a person, other than a brother or sister (whether of the whole or half blood), with respect to whom a loss resulting from the transfer would be disallowed under section 24(b).

(4) *Applicability.*—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer described in paragraph (1) in any taxable year beginning after May 31, 1950, regardless of the taxable year in which such transfer occurred.

(26 U. S. C. 1952 ed., Sec. 117.)

Statement

The facts material to this appeal, as found by the District Court (R. 16-19), and as they appear from five agreements relating to taxpayer's patents which were Exhibits A through E to taxpayers' complaint,[3] may be summarized as follows:

On April 17, 1934, a patent was issued to taxpayer covering a wood cleated corrugated shipping container.

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[3] The proper construction of these five patent agreements is the crux of the dispute in this litigation, as is evident from the District Court's opinion and taxpayers' brief on appeal. Taxpayers challenge the District Court's summary of the agreements as not "completely accurate" (Br. 3), but they do not print the agreements as part of their record appendix. Instead, they state that (Br. 3): "Three typewritten copies of each agreement will be filed with this brief." We assume that this was done with

Three additional patents for improvements of this container were issued to taxpayer on October 9, 1934, December 27, 1938, and May 13, 1939. In March, 1937, taxpayer entered the employ of Dillman Industries, Inc., and executed an agreement with Dillman giving the corporation a non-exclusive license to manufacture containers under taxpayer's patents. The manufacture and sales of the containers proved successful and early in 1940, after the last two patents in question had been issued, taxpayer began negotiating with some of the officers and leading shareholders of Dillman, who were acting both on behalf of the corporation and of themselves personally, relative to new agreements for the exploitation of the patents. During the negotiations a new corporation, Watkins Patents, Inc., was organized; taxpayer became the owner of 20 per cent of the shares issued and outstanding, and the remaining 80 per cent of the shares were acquired by Dillman or officers and shareholders of that corporation. (R. 16-17.)

On April 17, 1940, taxpayer's four patents were the subject of five agreements entered into simultaneously which may be summarized as follows (R. 17-19; Ex. A, Appendix, *infra;* Exs. B, C, D and E):

1. An agreement between taxpayer and Watkins Patents, Inc. (Ex. A, Appendix, *infra*) whereby taxpayer represented that he was the sole owner of the patents in question and agreed to transfer to the corporation "the

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leave of this Court, and that we may refer to the terms of the agreements, as taxpayers do, although they are not printed. However, for the convenience of the Court, we are printing the principal agreement (Exhibit A) as an appendix to this brief.

Contrary to taxpayers' assertion, we believe that the District Court's summary of the five agreements is thoroughly accurate, so far as it goes. Taxpayers themselves fail to specify any inaccuracies.

non-transferable exclusive license for the use of and sub-licensing under" the patents, together with improvements thereon or extensions thereof, for the life of the patents. (Par. II.) In consideration of this transfer, the corporation agreed to pay taxpayer $3,800 in cash, one-fifth of all the issued capital stock of the corporation, and one-third "of the net royalties collected by it from all products sold under" the patents, subject to minor qualifications. (Par. III.) The corporation agreed to account to taxpayer for the manufacture and sale of the patented container by its licensees, and to "use its best efforts to see that the provisions of all sub-license agreements are faithfully carried out by the respective sub-licensees." (Par. IV.) It was further agreed that if and when taxpayer severed his connection with Dillman Industries, Inc., he should "have a right to establish a business of his own to operate under" the patents; that the corporation should issue a non-exclusive sub-license to taxpayer; that if taxpayer formed a connection with some corporation, individual or co-partnership to operate such a business, and thereafter terminated such connection, the corporation, individual or co-partnership, would have the right, if desired, to "obtain a standard sub-license" from the corporation; and that, thereafter, taxpayer should have the right "to make use of his sub-license * * * either individually or in association with some other individual, co-partnership or corporation which he may thereafter select." All prospective sub-licensees were to be subject to approval by the taxpayer. (Par. VI.) The corporation undertook to defray the expenses of patent litigation up to the amount of $10,000, and it was provided that, upon failure of the corporation to fulfill this obligation, taxpayer should have the right to "cancel this contract * * *." As to litigation expenses in excess of $10,000, taxpayer

could assume them if the corporation did not wish to, and if taxpayer then prosecuted the litigation to a successful conclusion, he was entitled to reimbursement for his expenses from the corporation. (Pars. VII and VIII.) Taxpayer was to be president and a director of the corporation, co-manager of its business, and an employee of the corporation for the purpose of servicing sub-licensees. (Pars. IX and X.) Taxpayer agreed that, upon obtaining "an extension or improvement" of any of the patents in question, he would issue a non-transferable exclusive license therefor to the corporation, provided the corporation reimbursed him for the expenses in obtaining the extension or improvement. Absent such reimbursement, "the right, interest or patent for which payment is refused shall not be included under this contract." (Par. XI.) Finally, taxpayer agreed to provide copies of the agreement and assignments of prior licenses in proper form for filing in the United States Patent Office. (Par. XII.)

2. An agreement (Ex. B) between Watkins Patents, Inc., and Dillman Industries, Inc., whereby Dillman received a nontransferable, non-exclusive sub-license to manufacture and sell the patented container, and agreed in consideration thereof to pay the licensor royalties of one per cent of the net sales of the containers, such royalties to become 1½ per cent in the event taxpayer's employment by Dillman was terminated. Dillman agreed to submit to the licensor a detailed monthly account of its sales. The licensor agreed to assume and conduct at its own expense any patent infringement litigation.

3. An agreement (Ex. C) between taxpayer and Dillman Industries, Inc., whereby the license previously granted to Dillman by taxpayer was cancelled. It was agreed that taxpayer's existing employment contract with

Dillman should be replaced by a new contract (terminable by either party at the end of any year) whereunder taxpayer should receive $400 per month and 25 per cent of Dillman's net income from the sale of products covered by taxpayer's patents. Dillman agreed, upon certain terms and conditions, to sell to taxpayer up to 200 shares of its treasury stock.

4. An agreement (Ex. D) between taxpayer, Dillman Industries, Inc., and Watkins Patents, Inc., which incorporated the agreement constituting Exhibit A, cancelled the previous license given by taxpayer to Dillman, and provided for the issuance of the sub-license from Watkins Patents, Inc., to Dillman which constitutes Exhibit B. The agreement contained certain other provisions, including Dillman's promise to loan Watkins Patents, Inc., certain amounts for the purpose of paying litigation expenses that might arise in defense of taxpayer's patents, in accordance with the terms of Exhibit A. The preamble to this agreement recites that taxpayer is the owner of the patents in question; that he desires "a wider and more general use of, and more extensive manufacture of containers covered by his patents"; that to accomplish this he has proposed to Dillman Industries, Inc., that Dillman "enter into a contract with him for the exclusive handling of his patents by means of licensing various individuals and firms" to manufacture the patented container; and that Dillman, realizing the advantage of such an arrangement, has caused Watkins Patents, Inc., to be organized.

5. An agreement (Ex. E) between taxpayer and Watkins Patents, Inc., whereby the corporation purported to grant taxpayer a nontransferable, nonexclusive sub-license to manufacture and sell the patented container in return

for royalty payments of 1½ per cent of the net sales of such containers. It was agreed that the license was not to be used by taxpayer as long as he was employed by Dillman Industries, Inc., but that upon leaving the employ of Dillman taxpayer should have the right, either independently or in association with other interests, to manufacture and sell under the license. It was further agreed that, if taxpayer entered into such a business association and thereafter terminated it, taxpayer might continue to use his license, either individually or in association with other interests. Any ex-associates of the taxpayer in such a business were to be entitled to a sub-license upon termination of the association. The agreement also contained provisions for monthly accountings by taxpayer to Watkins Patents, Inc., and for the conduct of any patent infringement litigation by the corporation at its own expense.

The District Court found as ultimate facts (R. 19) that the agreement between taxpayer and Watkins Patents, Inc. (Ex. A, Appendix, *infra*), did not effect the transfer from taxpayer to the corporation of all substantial rights to the patents in question, and that the parties did not intend that the agreement should effect such a transfer.

The District Court concluded as a matter of law (R. 20) that the agreement between taxpayer and Watkins Patents, Inc. (Ex. A), did not constitute a sale or assignment of the patents in question, but was only the grant of a license; and that the income reported by taxpayers in their 1949 through 1952 returns and derived from the licensing by taxpayer of Watkins Patents, Inc., was ordinary income and not capital gains.

Summary of Argument

In this case the taxpayer transferred certain patent rights to a corporation in 1940, retaining a royalty interest and certain other rights. The question in this litigation is whether royalties received by the taxpayer from the corporation, in the years 1949 through 1952, constituted ordinary income or capital gains. In statutory terms, the question as to the tax years 1949 and 1950 is whether there was a "sale" of the patents in question under Section 117(a)(4) of the 1939 Code, or merely a license of patent rights. The question as to the tax years 1951 and 1952 is whether there was a transfer of "all substantial rights" to the patent within the meaning of Section 117(q) of the 1939 Code. It is clear that, if the taxpayer failed to transfer "all substantial rights" under Section 117(q), he also failed to effect a "sale" under Section 117(a)(4).

The District Court found as an ultimate fact, taking into account the terms of the instrument transferring patent rights, the terms of related instruments, and the testimony of taxpayer and his witnesses, that the parties neither intended nor effected the transfer of all substantial rights to the taxpayer's patents. This finding in amply warranted by the record. The corporation to which the patent rights were transferred, Watkins Patents, Inc., was created solely for the purpose of sub-licensing taxpayer's patents, with taxpayer retaining the right to veto prospective sub-licensees. The rights to manufacture and sell the patented product were not transferred to the corporation, which received only an "exclusive license for the use of and sub-licensing under" the patents. Moreover, taxpayer retained a so-called sub-license in his own right to manufacture and sell, and the power to confer further sub-licenses without limit on ex-business associates.

Taxpayers concede that the corporation was not intended to manufacture the patented product, but merely to sub-license. Nevertheless, they contend that the phrase, "for the use of," in the granting clause of the instrument transferring the right to sub-license to the corporation, was effective as a matter of law to transfer the rights to manufacture and sell. The authorities they cite do not bear out the proposition that the right to use carries with it, as a matter of law, the rights to manufacture and sell. And in this case it is clear that what was intended and effected by the grant "for the use of," as the District Court held, was simply the right to exploit the patents by sub-licensing.

Taxpayers also rely upon testimony of their witnesses below that the parties intended to transfer ownership of the patents to the corporation. But this testimony is conclusional and self-serving. Insofar as the testimony below bore upon intent to transfer specific rights, powers and obligations, it is fully compatible with the terms of the instrument of assignment, which conveyed only the right to sub-license, the right to share in royalties, and the right to conduct or participate in infringement litigation. The rights to manufacture and sell were not transferred; such rights were obviously substantial; and, in addition, taxpayer retained certain other incidental rights which are cumulatively impressive.

We believe that the other arguments advanced by taxpayers are patently without merit, and that the District Court correctly held the royalties received by the taxpayer to be ordinary income, under a license arrangement, rather than capital gains in the nature of proceeds from the sale of the patents.

ARGUMENT

The royalties received by taxpayer as transferor of patent rights constituted ordinary income, because taxpayer did not transfer all substantial rights to the patents within the meaning of Section 117(q) of the 1939 Code, or sell the patents within the meaning of Section 117(a)(4) of the same Code.

Taxpayer was the inventor and patentee of a shipping container. In 1940 he transferred certain rights under his container patents to Watkins Patents, Inc., retaining a royalty interest and certain other rights. Thereafter, he received substantial royalties from the corporation. He and his wife reported these royalties as ordinary income in the four tax years here involved (1949 through 1952), but now claim a refund for those years on the ground that the royalties should have been reported as long-term capital gain.

Whether royalties received by a transferor of patent rights constitute ordinary income or capital gain is a question which has been much litigated over the years, in a great variety of factual contexts. Until 1950 the relevant statutory criteria were provided by Section 117(a) of the Internal Revenue Code of 1939, *supra*. In statutory terms the question was whether the transfer of patent rights effected the "sale or exchange of a capital asset held for more than 6 months," within the meaning of Section 117(a)(4), the term "capital asset" being defined by Section 117(a)(1). In the case at bar, it is undisputed that the patents in question were capital assets held for more than six months prior to the disputed trans-

fer in 1940, so that the sole question—as to the tax years 1949 and 1950—is whether there was a "sale" of the patents within the meaning of Section 117(a)(4).

The courts have not always agreed as to what constitutes the "sale" of a patent under Section 117(a)(4), as opposed to a mere license. We believe that the law in the Second Circuit is sufficiently spelled out for the purposes of this case in *Cory* v. *Commissioner*, 230 F. 2d 941, certiorari denied, 352 U. S. 828. See also *Bloch* v. *United States*, 200 F. 2d 63 (C. A. 2d), certiorari denied, 345 U. S. 935. In *Cory* the owner of a copyright transferred certain rights thereunder to Scribner's, retaining a royalty interest and certain other rights, including foreign publication rights, movie and dramatic rights, and first serial rights. This Court held that the transfer did not effect a sale, saying (p. 944):

> We do not now decide that a transfer by a citizen of but a part of the bundle [of rights] for a definite sum, or a transfer of the whole for an indeterminate sum, is a sale for purposes of Section 117.[5] We do hold that when, as here, the transfer is both (1) a transfer of a part of the cluster of rights and (2) for an amount wholly indeterminable at the time of the transfer, no such sale occurs.

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[5] The taxpayers cite *Commissioner of Internal Revenue* v. *Hopkinson*, 2 Cir., 126 F. 2d 406 and *TeLinde*, 18 T.C. 91 as authority for their contention that the transfer of a copyright interest for a price to be fixed by the future profits can constitute a sale. In *Hopkinson*, this court held that the transfer of a patent was a sale, despite the fact that the payment turned on future sales. In *TeLinde*, the Tax Court held similarly in dealing with the transfer of a copyright. However, in both cases the taxpayers transferred the entire bundle, so that they no longer retained any interest in them. They had only the right to receive periodic payments of money.

It is evident, we believe, that this broad rationale is as applicable to patents as to copyrights, and requires the conclusion that a patent has not been sold, within the meaning of Section 117(a)(4), where a transferor of patent rights retains *both* a royalty interest *and* "a part of the cluster of rights" inhering in the ownership of a patent. See *Bloch* v. *United States*, *supra*.

As to the tax years 1951 and 1952, the controlling statutory provision is Section 117(q) of the 1939 Code, *supra*, which was added by legislation effective June 29, 1956. Subject to certain limitations, this provision specifically governs the tax treatment of royalties received by transferors of patent rights, and it is retroactive in terms to royalties received in any taxable year beginning after May 31, 1950. Section 117(q)(4). Substantively, it is provided that a transfer of patent rights "shall be considered the sale or exchange of a capital asset held for more than 6 months," despite the retention by the transferor of a royalty interest, if certain requirements are met. One of those requirements is that the transfer must embrace "all substantial rights to a patent." Section 117(q)(1). That is the requirement which is material to this litigation, it being undisputed that the other requirements of the section are met.

Whether "all substantial rights" to a patent have been transferred, within the meaning of Section 117(q)(1), is a test which can best be understood in the light of legislative history. Section 117(q) is substantially the same as Section 1235 of the Internal Revenue Code of 1954, and was enacted in order to make the provisions of Section 1235 retroactive to 1950. S. Rep. No. 1941, 84th Cong., 2d Sess., p. 5 (1956-2 Cum. Bull. 1227, 1229). Thus the legislative history of Section 1235 is pertinent,

and particularly the following passage (S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 439-440 (3 U. S. C. Cong. & Adm. News (1954) 4621, 5081, 5083)):

> The section does not detail precisely what constitutes the formal components of a sale or exchange of patent rights beyond requiring that all substantial rights evidenced by the patent (other than the right to such periodic or contingent payments) should be transferred to the transferee for consideration. This requirement recognizes the basic criteria of a "sale or exchange" under existing law, with the exception noted relating to contingent payments * * *. To illustrate, exclusive licenses to manufacture, use, and sell for the life of the patent, are considered to be "sales or exchanges" because, in substantive effect, all "right, title, and interest" in the patent property is transferred (irrespective of the location of legal title or other formalities of language contained in the license agreement). Moreover, the courts have recognized that an exclusive license agreement in some instances may constitute a sale for tax purposes even where the right to "use" the invention has not been conveyed to the licensee, if it is shown that such failure did not represent the retention of a substantial right under the patent by the licensor. It is the intention of your committee to continue this realistic test, whereby the entire transaction, regardless of formalities, should be examined in its factual context to determine whether or not substantially all rights of the owner in the patent property have been released to the transferee, rather than recognizing less relevant verbal touchstones. The word "title" is not employed because the retention of bare legal title in a transaction involving an exclusive license

> may not represent the retention of a substantial right in the patent property by the transferor.

In sum, whether "all substantial rights" have been transferred is a question of fact which must be determined upon the peculiar circumstances of each case; and the determination of this question is not controlled by "verbal touchstones," by the retention of bare legal title, or by the retention of patent rights which, in fact, are without substance.

Comparing this requirement of Section 117(q) with the requirements for a "sale" under Section 117(a)(4) in the light of *Cory*, it would appear that the dispositive question is substantially the same under both statutory provisions, so far as the instant case is concerned. In *Cory* this Court held that where only a part of the cluster of rights is transferred, for an amount wholly indeterminable at the time of transfer, no sale occurs. It follows that, where a royalty interest is retained, as in the case at bar, in the absence of a transfer of all of the cluster of rights there cannot be a "sale" under Section 117(a)(4)—a test which is obviously close to the requirement of Section 117(q) that "all substantial rights" be transferred. If anything, the test in *Cory* would seem to be somewhat stricter, since no distinction is there made between substantial and insubstantial rights.

At any rate, there is no need here to consider whether a stricter rule is applicable under Section 117(a)(4) than under Section 117(q), with respect to the quantum of rights which must be transferred.[4] At the least, it is clearly necessary under both provisions that *all sub-*

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[4] The court left open the question whether, even if the entire bundle of rights is transferred, a sale is nonetheless precluded if the consideration consists of royalty payments rather than a definite sum.

stantial rights be transferred, and we submit that the court below correctly contended that this requirement has not been met in the case at bar.

The disputed transfer of patent rights in the instant case was effected by an agreement between the taxpayer and Watkins Patents, Inc., summarized in the statement. (Ex. A, Appendix, *infra.*) This agreement was executed simultaneously with certain other related agreements, also summarized above. (Exs. B, C, D and E.) The District Court properly took the view that the five instruments (R. 22)—

> must all be construed together. What the parties intended by a particular phrase or provision in the agreements must be found from the language itself, its context in the written instrument of which it is a part and the other four agreements, all considered against the background of the surrounding circumstances.

Moreover, the District Court took into account the testimony of taxpayer and his witnesses (R. 20) "relative to the history of the parties to the contracts * * *, the business relationship of the parties and the negotiations before and during the making of the agreements as well as some testimony as to what the parties to the contracts actually did pursuant to them." And in making this broad factual assessment, the court recognized (R. 21) that no particular words of art are necessary, but that the principal agreement (Ex. A) "must in the language it employs in the context of the case convey all substantial rights to the patent, and the language used must be broad enough for this purpose." Pursuant to this assessment, the court found as an ultimate fact that (R. 19):

> The agreement between James R. Watkins and Wat-

> kins Patents, Inc. did not transfer from James R. Watkins to the corporation, nor did the parties intend that it should transfer, all the substantial rights to the patents.

Accordingly, it held (R. 28) that the royalties in question are taxable as ordinary income and not as capital gains.

We submit that the District Court applied the correct criteria; that it made the broadest and least technical analysis possible of all material facts; and that its ultimate finding that taxpayer failed to transfer all substantial rights to his patents is amply warranted by the record, to which we now turn.

The preamble to one of the related agreements here involved contains this illuminating passage (Ex. D, p. 1):

> First Party [taxpayer] is desirous of having a wider and more general use of, and more extensive manufacture of containers covered by his patents, and to accomplish this has approached and proposed to Second Party [Dillman Industries, Inc.] that Second Party enter into a contract with him for the exclusive handling of his patents *by means of licensing various individuals and firms* throughout the United States of America to manufacture crates under the above referred to patents owned by First Party. (Italics supplied.)
>
> Second Party realizes and sees the advantage of such an arrangement and has caused to be organized * * * a corporation, Party of the Third Part under this agreement, known and designated as Watkins Patents, Inc.

The purposes thus stated are confirmed by the testimony of taxpayers' witnesses. Mr. Dillman, a substantial stock-

holder of Dillman Industries, Inc., and also of Watkins Patents, Inc., stated (R. 5) that taxpayer "was anxious to get the box more generally accepted across the country, and the only way that could be done would be to license others to do it." Mr. Dillman also stated (R. 6) that, while taxpayer "wanted to expand the use of the patents * * * he realized to do it would take considerable amount of financing or money, which he didn't have." And further that (R. 9) "we created the new corporation so that it could handle the licensing end of it. We didn't want that involved in Dillman Industries." The same witness testified (R. 10) that Watkins Patents, Inc., was not created to engage in the manufacture of the patented container.

In sum, then, the parties created Watkins Patents, Inc., specifically to handle the sub-licensing of taxpayer's patents. And this limited purpose is clearly reflected and carried out in detail in the principal agreement between taxpayer and Watkins Patents, Inc. (Ex. A.) In paragraph II of this instrument it is provided that taxpayer "does hereby transfer and grant unto said Second Party [Watkins Patents, Inc.] the non-transferable exclusive license for the use of and sublicensing under each and all of the above referred to patents * * *." In paragraph III (c) the corporation "agrees to pay to said First Party [taxpayer] one-third (⅓) of the net royalties collected by it from all products sold under said Letters Patent * * *." And this provision is referred to in the concluding sentence of paragraph III as "the above referred to division of license fees * * *." In paragraph IV the corporation—

> agrees to keep suitable record and account books showing the manufacture and sale of containers by its licensees under this agreement, which record and

> account books shall be open to inspection by said First Party or his duly appointed agent at all reasonable times during business hours. Said Second Party further promises and agrees * * * that it will use its best efforts to see that the provisions of all sublicense agreements are faithfully carried out by the respective sub-licensees.

Paragraph V provides that the corporation is not a guarantor as to payments by other licensees, its only obligation being to exert its best efforts to see that sublicense agreements are faithfully carried out by all sublicensees.

Thus it is abundantly clear that Watkins Patents, Inc., was created solely to serve as a sub-licensing agency, and was endowed with the rights and obligations relevant to that function. It was not intended that the corporation manufacture and sell the patented container—as, indeed, taxpayers concede (pp. 11, 17) in their brief on appeal. Nor did the principal agreement (Ex. A) purport to transfer to the corporation the rights to manufacture and sell. It transferred only the "non-transferable exclusive license for the use of and sublicensing under" the patents in question. Under these circumstances, taxpayers are not helped by their argument (Br. 18) that several years after the agreements in question were executed "the situation might well have changed so that the parties may then have caused Watkins Patents, Inc. to manufacture." We are not concerned in this litigation with any conjectural modifications of the parties' original intention or of their original agreements; no such modifications appear of record; taxpayers must therefore be held to what was intended and done in 1940, when the instruments in question were executed.

It is axiomatic that the rights inhering in a patent include the exclusive rights to manufacture, use, and sell. See, e. g., *Broderick* v. *Neale*, 201 F. 2d 621 (C. A. 10th); *Watson* v. *United States*, 222 F. 2d 689 (C. A. 10th); and *Allen* v. *Werner*, 190 F. 2d 840 (C. A. 5th). Cf. *Waterman* v. *Mackenzie*, 138 U. S. 252. In a given case, one or more of these rights may not be substantial, as recognized by the legislative history pertinent to Section 117(q), quoted above. The example given in that history is of situations where the right to use is of no substance.

In the case of product patents it is obvious that the rights to manufacture and sell are the major rights of value. Here, it was the manufacture and sale of taxpayer's patented container on an expanded scale which the parties hoped to promote. But Watkins Patents, Inc., was neither intended nor empowered to manufacture and sell; it was created only to sub-license those rights. Moreover, the corporation did not have a free hand in determining to whom sub-licenses should be given. Taxpayer reserved to himself the power to veto sub-licensees. (Ex. A, par. VI.)[5] And under other provisions of the principal agreement, as the District Court pointed out (R. 28)—

> Once he had left the employ of Dillman Industries, Inc., which he could do at his own volition after a year, Watkins could associate himself with another to manufacture and sell and that other would gain and retain a license even after Watkins had become disassociated from him; and thereafter Watkins could make a new association with someone else, who would thereby also gain a license and so on without limit.

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[5] Taxpayers' attempt to dismiss this veto power (Br. 23-24) is not convincing in the face of testimony below that discussion between taxpayer and other parties as to the acceptability of prospective licensees (R. 9) "often became quite heated." Taxpayer obviously considered the power as something more than an empty formality.

> At the same time he could veto the granting of licenses by Watkins Patents, Inc. to someone of whom he did not approve. *He possessed power to do more than his transferee could do.* (Italics supplied.)

It is evident, then, that Watkins Patents, Inc., could only sub-license the rights to manufacture and sell; that taxpayer retained an enforceable right to control such sub-licensing through his veto power; and that taxpayer also retained, for himself and any future business associates, free of any control by the corporation, the rights to manufacture and sell. The only realistic conclusion, we submit, is that the exclusive rights to manufacture and sell did not pass to the corporation. Those rights were obviously substantial. Hence the District Court correctly found that taxpayer failed to transfer all substantial rights to the corporation.

In assailing this result, taxpayers argue first that the rights to manufacture and sell were transferred to the corporation, by operation of law, despite the conceded intention of the parties and the provisions of the instruments discussed above. They base this contention on the fact that the granting clause of the principal instrument (Ex. A) contains the words, "for the use of," alleging that (Br. 10) "it is well established by usage of the United States Supreme Court that a transfer of the exclusive use of a patent is a precise expression of an assignment of the right to make, use and sell under the patent." They cite (Br. 9) two Supreme Court decisions in support of this argument, *Hartford-Empire Co.* v. *United States*, 323 U. S. 386, and *Paper Bag Patent Case*, 210 U. S. 405. These cases do not support taxpayers' contention. *Hartford-Empire Co.* was an antitrust case in which the Supreme Court simply observed, in the language quoted by

taxpayers (Br. 9), that a patent owner has the option to use his patent, license it to others, or retain the patent without using it. Similarly, in the *Paper Bag Patent Case*, which was an infringement suit, the Court said that a patentee may exclude others from the use of the patent. In these generalized observations the Court apparently spoke of using a patent in the sense of exercising some or all of the rights thereunder; but such informal, shorthand references certainly do not constitute a holding that a formal instrument which merely conveys the right to *use* is effective, as a matter of law, to convey the rights to manufacture and sell under a patent. Indeed, in *Waterman* v. *Mackenzie*, 138 U. S. 252, which was in infringement suit like *Paper Bag Patent Case*, the Supreme Court held that the several rights to manufacture, use and sell must be conveyed in clear language if the transfer is to effect more than the granting of a mere license.[6]

It is true that the courts, as noted above, do not require any particular words of art for the transfer of the exclusive rights to manufacture, use and sell. But in all cases which we have been able to discover the courts have required the transfer of substantially all the rights in the patent. Thus in *Daily* v. *Universal Oil Products Co.*, 76 F. Supp. 349 (N. D. Ill.), which taxpayer invokes (Br. 9-10), a process patent was involved, and the court held that a grant of (p. 356) "the exclusive *use and control of the process*" was a transfer of all substantial rights. (Italics supplied.) And it reached this conclusion in the factual context of the case, pointing out that (p. 356) "the title of Sunset Oil Refining Company to the patents was constantly advanced and acknowledged by the actions of

[6] Moreover, as this Court observed in the *Bloch* case, *supra* (p. 65) an assignment of a patent in non-tax cases "is not necessarily controlling in the field of taxation."

both parties." Similarly, in *Associated Patentees, Inc.* v. *Commissioner*, 4 T. C. 979, the agreement which taxpayers quote (Br. 10) had been preceded by a formal assignment, whereby all right, title and interest to the patents in question had been formally transferred to the corporation. As for *Reid* v. *Commissioner*, 26 T. C. 622, taxpayers quote (Br. 10) only part of the significant language of the granting clause, under which the taxpayer (p. 628) "hereby grants to the corporation the exclusive and continuing right * * * to utilize her design patents and/or process patents, now existing or hereafter obtained, *in the manufacture and sale of the corporation's products.*" (Italics supplied.) *Pike* v. *United States*, 101 F. Supp. 100 (Conn.), also involved process patents, and the transferee was not only empowered to sub-license but also to utilize the processes in the direct manufacture and sale of goods—in sharp contrast to the situation in the case at bar.

We submit that the District Court was fully warranted in the instant case in holding, as to the phrase "for the use of" in the granting clause of the principal instrument, that it is clear (R. 24) "from its context, the surrounding circumstances and the witnesses' testimony, particularly Mr. Dillman's, that use meant the exploitation of the patents by issuing licenses."

Taxpayers next argue (Br. 12-14) that the District Court erred in rejecting testimony below by taxpayer and his associates that they intended ownership of the patents in question to pass to the corporation. This testimony, however, in addition to being self-serving so far as taxpayer is concerned, is obviously conclusional in nature. The testimony of the lay witnesses in this case is competent only with respect to the transfer of specific

rights, powers and obligations under the patents in question. As so limited, the testimony below is fully compatible with the provisions of the principal agreement which transfer to the corporation only the following rights: (1) the right to sub-license, (2) the right to a share in the royalties collected by the corporation from sub-licensees (thus giving the Dillman interests a return for their investment in Watkins Patents, Inc.), and (3) the right to conduct or participate in infringement litigation (for the protection of the stockholders, principally the Dillman interests). These rights do not add up to ownership, for they do not include the substantial rights retained by the taxpayer which we have discussed above.

Taxpayers next argue (Br. 14-15) that the rights received and obligations assumed by Watkins Patents, Inc., with respect to the conduct of infringement litigation compel the conclusion that an assignment and not a license was intended and effected. This argument is as unsound as its predecessors. It is, of course, well-settled that an assignment of a patent, as distinguished from a license, carries with it *by operation of law* the right to sue for infringement. *Waterman* v. *Mackenzie*, *supra*; *E. W. Bliss Co.* v. *United States*, 253 U. S. 187. It does not follow that the express transfer of the right to sue for infringement is incompatible with a license, or operates to convert into an assignment what would otherwise be a license, no matter how many substantial rights are withheld. At most, the transfer of such a right may shed some light on the intent of the parties, as in *Pike* v. *United States*, *supra*, where it was held that such a transfer, taken together with the other facts of the case, revealed that (101 F. Supp., p. 101) "the operative intent was plainly to pass all the rights the plaintiff had." In the case at bar, in contrast to *Pike*, we have seen that the

exclusive rights to manufacture and sell were not conveyed to the corporation; these rights were obviously substantial; and we submit that no arrangement with respect to infringement litigation can alter the fact that only a license was intended and effected.

Taxpayers argue further (Br. 16-19) that the effect of the District Court's decision is to prevent the assignment of patents to holding companies. This is obviously untrue. When all substantial rights to a patent are transferred, an assignment is accomplished, whether the assignee be a holding company, an operating corporation, or an individual. Taxpayers confuse the property rights of a holding corporation with its functions. Once a corporation has acquired ownership of patents it is immaterial, of course, to what extent the stockholders choose to limit the corporation's direct exercise of the patent rights. But all substantial rights must be transferred in the first instance if the corporation is to be deemed an assignee, as distinguished from a licensee. One of the cases invoked by taxpayers in this connection (Br. 17), *Associated Patentees, Inc.* v. *Commissioner*, *supra*, is illustrative. In that case, as noted above, all right, title and interest in the patents involved were expressly conveyed to the corporation; hence the corporation was a true assignee, regardless of the manner in which it exploited the patents.

Finally, taxpayers contend (Br. 20-26) that certain incidental rights reserved by the taxpayer under his patents were incorrectly regarded by the District Court as indicia of a license. But in analyzing these rights severally, taxpayers are only demonstrating what the District Court itself recognized (R. 26-27), that is, that none of these rights, taken alone, is of such character that its retention will preclude a transfer of patent rights from

constituting an assignment. The District Court viewed these incidental rights cumulatively, in context with the retention of the clearly substantial rights to manufacture and sell, and held (R. 27):

> It is necessary to draw the line somewhere, and it seems plain that Watkins came out of the agreements with such extensive interest that even assuming, *arguendo*, an initial assignment in the granting clause of the contract between him and Watkins Patents, Inc., he finally as a result of the whole transaction, conveyed no more than a license.

CONCLUSION

For all of the reasons set forth above, we submit that the judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

CHARLES K. RICE,
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Department of Justice,
Washington 25, D. C.

SIMON S. COHEN,
United States Attorney

October, 1957.

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APPENDIX

Exhibit A

AGREEMENT BETWEEN
JAMES R. WATKINS, PARTY OF THE FIRST PART
AND
WATKINS PATENTS, INC., PARTY OF THE SECOND PART

THIS AGREEMENT made and entered into this 27th day of April, A. D. 1940 by and between JAMES R. WATKINS, of Niles Center, Illinois, Party of the First Part, and WATKINS PATENTS, INC., a corporation organized under the laws of the State of Illinois and having its principal office at Quincy, Illinois, Party of the Second Part.

WITNESSETH:

WHEREAS, said Party of the First Part is the owner of United States Letters Patent No. 1,955,107 dated April 17, 1934, for Container; United States Letters Patent No. 1,976,693, dated October 9, 1934 for Container; United States Letters Patent No. 2,141,497, dated December 27, 1938 for Container; and United States Letters Patent No. 2,159,642, dated May 23, 1939 for Container;

WHEREAS, said Party of the Second Part is desirous of obtaining a non-transferable exclusive license to each and all of said issued Letters Patent, including each and every part or subdivision thereof and including the inventions covered by each and all of same, together with any and all improvements of the respective patented inventions that may hereafter be issued or authorized, and the sole

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right to issue license for manufacturing and selling containers covered by these patents upon the terms and conditions hereinafter set forth.

Now, THEREFORE, in consideration of the mutual promises and agreements hereinafter set forth of the parties hereto and the sum of One Dollar ($1.00) and other valuable considerations each to the other in hand paid, receipt of which is hereby acknowledged, by each of the parties hereto, the parties hereto have agreed as follows:

I.

Said Party of the First Part represents that the only license agreements now in force in respect of the above patents are the following:

Container Patents, Inc., Chicago, Illinois.
Dillman Industries, Inc., Caruthersville, Missouri.
The Eddy Paper Co., Chicago, Illinois.
Kieckhefer Container Co., Milwaukee, Wisconsin.
The Love Box Company, Wichita, Kansas.
Collins F. Fuller, Chicago, Illinois.

II.

Said Party of the First Part further represents and agrees that he is the sole owner of said Letters Patents and as such owner has the right to issue non-transferable exclusive licenses for the use of and sublicensing under each and all of said United States Letters Patent and the inventions covered by each and all thereof, including each

and every part or subdivision thereof, together with any and all improvements or extensions of the respective patented inventions and said First Party for the consideration hereinafter expressed and the agreements of Second Party herein does hereby transfer and grant unto said Second Party the non-transferable exclusive license for the use of and sublicensing under each and all of the above referred to patents, including each and every part or subdivision thereof, together with the improvements thereon or extensions thereof for the life of said patents and each of same, or any part or parts or subdivisions thereof and for the period or periods of any renewals or extensions thereof, together with all licensing agreements heretofore made under said patents by First Party as hereinabove specifically set forth. All of same to be for the life of said patents and each and every extension and improvement thereon.

III.

In consideration of the grants, promises and agreements of the First Party made herein to Second Party the said Party of the Second Part promises and agrees to pay to said Party of the First Part all of the following:

(a) The sum of Thirty-eight Hundred Dollars ($3800.00) in cash.

(b) Second Party agrees to issue to said First Party as part of the consideration of the aforesaid one-fifth (1/5) of all the issued capital stock of this corporation. (Said one-fifth (1/5) amounting to the sum of 215 shares.) Said stock to be issued as no par stock, fully paid and

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non-assessable, being paid by rights and property received by this corporation.

(c) Said Second Party agrees to pay to said First Party one-third (⅓) of the net royalties collected by it from all products sold under said Letters Patent, including any improvements and extensions thereon, and including one-third (⅓) of all minimum royalties collected by virtue thereof. The amount so received by said First Party in no case shall be less than one percent (1%) of the net factory sales price of all crates manufactured under said First Party's patents or improvements thereon. (The net sale price above referred to shall be the sales price less any deductions made in respect of freight or in respect of cash allowances.)

It is, however, further agreed by and between the parties hereto that the above referred to division of license fees shall be limited to and apply only to license fees received by the party of the Second Part from its administration of said Watkins patents and shall not apply to any license fees or profits said Second Party may receive from any other sources.

IV.

Said Party of the Second Part promises and agrees to keep suitable record and account books showing the manufacture and sale of containers by its licensees under this agreement, which record and account books shall be open to inspection by said First Party or his duly appointed agent at all reasonable times during business hours. Said Second Party further promises and agrees to see that future sub-license agreements made by it shall contain

suitable provisions for the keeping of records and accounts and that it will use its best efforts to see that the provisions of all sub-license agreements are faithfully carried out by the respective sub-licensees.

V.

It is further understood and agreed by and between the parties hereto that the Party of the Second Part is not a guarantor as to payments by other licensees, its only obligation in the premises being to exert its best efforts to see that sub-license agreements are faithfully carried out by all sublicensees, including the payments of all royalties due.

VI.

Second Party recognizes the importance of these patents and inventions to First Party and their possible value to him in establishing a future business connection. Wherefore, it is understood and agreed that if and when said First Party shall hereafter sever his present connection with Dillman Industries, Inc., of Caruthersville, Missouri, he shall then have a right to establish a business of his own to operate under each and all of said letters Patent or to make a connection with any other individual, copartnership or corporation not having been a sub-licensee of Watkins Patents, Inc. under any of said Letters Patent. It is agreed by and between the parties hereto that Second Party shall issue to First Party simultaneously with the signing of this agreement a non-transferable non-exclusive sub-license under each and all of the aforesaid Letters Patents, including each and every part or subdivision

thereof, together with any and all improvements that may be hereafter authorized or issued in form Exhibit 1 hereto attached and made a part hereof as fully to all intents and purposes as if written herein. In case, however, the said Party of the First Part does form a connection with some corporation, individual or co-partnership for the purpose aforesaid and same shall thereafter be terminated upon the termination of same the said individual, corporation or co-partnership shall have the right, if desired, to obtain a standard sub-license from the said Party of the Second Part for the manufacturing of the products theretofore manufactured by First Party and his said associates. It being the intent that the termination of the operating agreement by the First Party and any individual or corporation or co-partnership with which he shall have associated himself shall not deprive the individual, co-partnership or corporation with which he was associated from thereafter continuing their business under a standard sub-license obtained from Second Party for like products. Neither shall the termination of same prevent said Party of the First Part from thereafter continuing to make use of his sub-license, Exhibit 1, either individually or in association with some other individual, co-partnership or corporation which he may thereafter select.

Said Party of the Second Part further agrees to seek sub-licenses immediately and issue sub-licenses to reliable applicants throughout the United States. The sub-licensees to be approved by said First Party. All sub-licenses are to be issued by Second Party for the period of the life of the patent under which same issued as authorized by the exclusive license to Party of the Second

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Part. In case said exclusive license issued to Second Party by First Party reverts to First Party by virtue of the terms hereof, then and in that event the sub-licensees may continue to operate under their sub-license agreement obtained from said Second Party and all license fees and payments thereunder shall after same has reverted to said First Party be paid by such sub-licensees to First Party.

VII.

Second Party further agrees that its net portion of all monies received from sub-licenses shall be held by it in a fund to be used for running expenses of the business and for the purpose of defraying any expense incurred by it in litigation for protection of the aforesaid patents until such fund has accumulated to an amount of Ten Thousand Dollars ($10,000.00) and if at any time said fund shall be less than Ten Thousand Dollars ($10,000.00) it will build up same to said amount by applying all of its portion of the net sums collected by it from sub-licenses until said amount equals Ten Thousand Dollars ($10,000.00) before any monies received from sub-licenses by it shall be distributed to the stockholders.

Said Party of the Second Part in order to obtain and have on deposit an initial sum available for the purpose of defraying any expense in patent litigation incurred by it agrees that it will immediately upon the execution of this agreement obtain a loan from Dillman Industries, Inc. of the sum of Two Thousand Dollars ($2,000.00) and keep said loan on deposit for the purpose of use in defraying and paying any expense incurred by it in patent litigation. It being understood and agreed by and be-

tween the parties hereto that the said Party of the Second Part shall repay said loan out of the first monies collected by it as its portion of net income from license agreements. This provision, however, is subject to prior repayment of sums due First Party under Paragraph VIII, if any.

VIII.

Said Second Party further agrees that should any patent litigation expense be incurred by it before sufficient funds have been accumulated by it either out of the Two Thousand Dollars ($2,000.00) obtained by it on loan as aforesaid, or accumulated out of income from sub-licenses, to defray such patent litigation expense so incurred by it that it will obtain an additional loan from Dillman Industries, Inc. for such additional amount or amounts as is needed by it for that purpose. All loans however, obtained by it from Dillman Industries, Inc. for said purpose shall not in any case exceed a total of Ten Thousand Dollars ($10,000.00) and any and all such loans so obtained by it from said Dillman Industries, Inc. for said purpose of defraying and paying expenses incurred by it in patent litigation shall be repaid by Second Party to said Dillman Industries, Inc. out of its proportion of receipts from sub-licenses thereafter received.

Should the said Party of the Second Part either fail, neglect or refuse to obtain a loan or loans from said Dillman Industries, Inc. amounting in all to the sum of Ten Thousand Dollars ($10,000.00) for the purpose of paying any expenditures incurred by it as needed for patent litigation, as aforesaid, then First Party may at his discretion and upon thirty (30) days notice in writing

to Second Party cancel this contract and in case of cancellation of same the full control and licensings under said patents are to revert to First Party as liquidated damages for breach of this agreement.

It is further stipulated and agreed that in case Second Party exhausts its funds accumulated by it for payment of expenditures incurred by it in patent litigation, as hereinabove provided, together with the additional sum or sums totaling Ten Thousand Dollars ($10,000.00) to be borrowed by it, as herein provided, from Dillman Industries, Inc. and provided further expenditures are necessary to properly continue prosecution or defense under such patent litigation and provided Second Party is unable to or refuses to continue to prosecute or defend further said patent litigation pertaining to aforesaid patents First Party thereupon has the right to take over and continue to prosecute or defend such patent litigation at his own expense, and if said referred to patent litigation under the aforesaid conditions is so carried on by First Party to a conclusion and said conclusion of said litigation sustains the issues in favor of Second Party it is agreed by and between the parties hereto that upon First Party's presenting to Second Party satisfactory evidence of the conclusion of said issues in said patent litigation favorably to Second Party and accompanies same with an itemized correct and signed statement of the expenses so incurred by First Party in the further carrying on of said patent litigation to its final termination, which resulted favorably to Second Party, Second Party will immediately thereupon give to First Party credits on its books for the actual expenses incurred, paid and established by First Party, as aforesaid, and same shall be

repaid to said First Party out of the first net collections received by First Party from sub-licenses thereafter until all such expenditures by First Party have been repaid. Said repayments to said First Party shall be made by said Second Party out of the aforesaid income received by it before any repayments are made therefrom to Dillman Industries, Inc. for loans theretofore made by it to Second Party.

It is agreed, however, that when the expenses so incurred and established by First Party, as aforesaid, are repaid to it then and thereafter all its portion of net sums collected by the said Party of the Second Part from sublicenses shall be paid to said Dillman Industries, Inc. until the loans obtained by Second Party from said Dillman Industries, Inc. are repaid in full and after the repayment of First Party of the amount expended by it, as aforesaid, and the repayment to Dillman Industries, Inc. of the loans obtained from it by Second Party, as aforesaid, all its portion of net collections from sublicensees thereafter received by Second Party shall be held by it and accumulated until a new fund of Ten Thousand Dollars ($10,000.00) is accumulated for the purpose of defraying and paying the expenses of business and any future patent litigation before any dividends or distributions shall be made to the shareholders of said corporation.

It is further understood and agreed that in consideration of said First Party paying the expenses of patent litigation, as aforesaid, after the Party of the Second Part has refused or is unable to carry same on, as aforesaid, then Second Party agrees with First Party that it will issue or cause to be issued to First Party a sufficient number

of shares of its capital stock of this corporation, which, together with the number of shares theretofore issued to him or upon his request or direction, shall together equal twenty-five percent (25%) of the total number of shares of capital stock issued and outstanding of this corporation at that time. All loans by Dillman Industries, Inc. to Watkins Patents, Inc. shall bear interest at a rate not exceeding Five Percent (5%) per annum.

IX.

It is further agreed by and on the part of the Party of the Second Part that it is a corporation incorporated under the laws of the State of Illinois; that it has an authorized outstanding capital of 1200 shares of no par value; that it has issued and outstanding or will immediately issue 1075 shares of capital stock of no par value, four-fifths (4/5) of which said stock so issued is issued for a paid in capital in cash of Five Dollars ($5.00) per share, and one-fifth (1/5) of said capital stock so issued is issued for property and rights of the value of Five Dollars ($5.00) per share; that this corporation is managed and controlled by an authorized Board of five Directors; that its officers consist of a President, a Vice-President, a Secretary and Treasurer and Assistant Secretary; that its Board of Directors elected for the first year of its organization are James R. Watkins, A. W. D. Weis, Kennett W. Dillman, James T. Ahern and Henry B. Weis; that its officers elected for the first year are James R. Watkins, President and Manager, A. W. D. Weis, Vice-President, Kennett W. Dillman, Secretary and Treasurer, and James T. Ahern, Assistant Secretary, Henry B. Weis,

Director. All of said officers and directors are shareholders. That the By-laws of this corporation provide that James R. Watkins and Kennett W. Dillman are designated and authorized by the Board of Directors as co-managers of this corporation. The By-Laws of this corporation also provide that the salary of each officer and director shall be One Dollar ($1.00) per year.

X.

It is further agreed by and between the parties hereto that it will be necessary for said Second Party to have available a competent party who can and will service licenses under sub-licenses granted by said Second Party pursuant to this agreement, and that the said Party of the First Part is competent and qualified for said work.

It is further agreed that said First Party is now employed by Dillman Industries, Inc. and said First Party by and with the consent of said Dillman Industries, Inc. has agreed and does agree to service all licensees of said Second Party for a charge of Fifteen Dollars ($15.00) per day plus traveling expenses incurred in the carrying on of said services, which said sum the Party of the Second Part agrees to collect from such licensees for such services actually rendered and said Second Party agrees to pay said sum so collected to Dillman Industries, Inc. Such amount so paid being to reimburse said Dillman Industries, Inc. for the time of said First Party and for his expenses paid by said Dillman Industries, Inc.

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XI.

Said Party of the First Part further represents and agrees that he will immediately hereafter upon the obtaining of an extension or improvement on any of the foregoing patents in this agreement referred to or immediately upon the obtaining of any new Letters Patent or his interests or rights in other patents on containers composed principally of fibre (more particularly known as corrugated paper and fibre board) and wood, or covering special construction and application of fibre board and wood, issue a non-transferable exclusive license for the use of and sub-licensing under each and all of said improvements or extensions of the aforesaid patents and under each and all of said new United States Letters Patents, or his interests or rights in other patents as above set forth, and the inventions covered thereby, including each and every part or subdivision thereof for the period or periods of any such renewals or extensions or any such new patents, all of same to be for the life of such extensions or improvements or such new patents. And it is understood and agreed that the Party of the Second Part is by this agreement authorized and empowered to make use of any and all improvements and extensions on the above and foregoing patents obtained by First Party and any and all new inventions obtained by him, and any and all interests or rights in other patents acquired by him, as aforesaid, and may authorize sub-licensees to use same prior and after the issuance by First Party to Second Party of new non-exclusive licenses, as herein provided, and said First Party shall not authorize any other person, individual, co-partner, or corpora-

tion to make use of in any way any such improvement or extension or new patent herein referred to.

It is understood and agreed that the said Party of the First Part will upon the obtaining of any improvement or extension on the above and foregoing patents in this agreement set forth or upon the obtaining of any new patent, or upon his obtaining any interest or rights in other patents, as herein referred to, submit to said Party of the Second Part a true and correct itemized account of his expenses actually incurred in the obtaining of same and each of same and said Party of the Second Part will thereupon repay to said First Party any and all such expenses. If Watkins Patents, Inc. should consider the expense or cost of any of the aforesaid greater than it desires to pay for same it may refuse to pay same, in which case the right, interest or patent for which payment is refused shall not be included under this contract.

XII.

It is further agreed by and on the part of the said Party of the First Part that contemporaneously with the signing of this agreement or thereafter upon request he will sign, execute and deliver to said Party of the Second Part another and additional exclusive non-transferable license agreement covering all of said Letters Patents hereinabove specified and set forth in accordance with the provisions of this agreement and will also make another and additional assignment to said Second Party of all licenses heretofore issued by him under said Letters Patents and will deliver all of same to the Party of the Second Part. Said additional assignments and agreements to be in proper form for properly filing in the United States

Exhibit A

Patent Office at Washington, D. C. and if said additional assignments and agreements are made as requested and shall not be in form as required by the United States Patent Office, or any department connected therewith, then and in that event the said Party of the First Part will upon request immediately sign, execute and deliver such assignment or assignments and agreements in form as required and requested by said Second Party in order to comply with the requirements of the United States Patent Office.

IN WITNESS WHEREOF, said Party of the First Part has hereunto set his hand and seal, and the said Party of the Second Part has caused these presents to be subscribed by its duly authorized Vice-President and attested by its Secretary and its corporate seal hereunto affixed, all done by virtue of authority duly given by the Board of Directors said Party of the Second Part. Four originals of this contract are signed and executed. All done the day and year first above written.

/s/ JAMES R. WATKINS (SEAL)
Party of the First Part.

WATKINS PATENTS, INC.
Party of the Second Part.

by /s/ A. W. D. WEIS
its Vice-President

SEAL

ATTEST:

/s/ K. W. DILLMAN
its Secretary